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No. 426

In the Supreme Court of the United States

October Term, 1931

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES P. LAUGHLIN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

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No. ——

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CHARLES P. LEININGER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above cause on June 30, 1931, reversing the decision of the United States Board of Tax Appeals. (R. 30.)

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 31) is reported in 51 F. (2d) 7. The findings of fact and opinion of the United States Board of Tax Appeals (R. 19–21) are reported in 19 B. T. A. 621.

JURISDICTION

The decision of the Circuit Court of Appeals, reversing the Board of Tax Appeals, was rendered June 30, 1931. (R. 31.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Respondent was a member of a partnership. He agreed with his wife that she should be an equal partner with him in his interest in the partnership, but by the agreement she did not become a member of the partnership. The question presented is whether, for income-tax purposes, his distributive share of the partnership income should be reduced by the amount paid to his wife pursuant to such agreement.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1070:

> SEC. 218. (a) That individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year, * * *.
>
> * * * * * *
>
> (d) The net income of the partnership shall be computed in the same manner and on the same basis as provided in section 212 * * * [with exception not material here].

The applicable section of the Revenue Act of 1921 (Sec. 218 (a) (c)), c. 136, 42 Stat. 227, 245, is identical.

Regulations 45, promulgated under the Revenue Act of 1918:

> ART. 321. *Partnerships.*—Partnerships as such are not subject to taxation under the statute, but are required to make returns of income. See section 224 of the statute and articles 411 and 412. Individuals carrying on business in partnership are, however, taxable upon their distributive shares of the net income of such partnerships, whether distributed or not, and are required to include such distributive shares in their returns. The net income of a partnership shall be computed in the same manner and on the same basis as the net income of an individual, * * * [with exception not material here].
>
> ART. 322. *Distributive shares of partners.*—The distributive share of the net income of a partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, * * *.

Articles 331 and 332 of Regulations 62 are substantially the same as Articles 321 and 322 of Regulations 45.

STATEMENT

The following facts were found by the Board of Tax Appeals (R. 19–21):

Prior to 1920 the respondent owned a one-half interest in a partnership known as the Eagle Laundry Company. (R. 19.) During the latter part of 1920, respondent entered into a written agreement with his wife, which confirmed a pre-existing oral agreement, wherein it was acknowledged that she had been and was a full, equal partner with him in his interest in the Eagle Laundry Company, entitled to share equally in the profits and obligated to bear equally any losses. (R. 20.) The agreement was effective from the beginning of 1920. The existence of this agreement was communicated to the representative of the owners of the other one-half interest in the Eagle Laundry Company. (R. 20.) There is no finding that such representative or his principals acquiesced or refused to acquiesce in this arrangement. The respondent's entire one-half interest in the partnership continued to stand in his name on the partnership books, and the partnership returns for the years 1921, 1922, and 1923, sworn to by respondent, disclosed the partners to be the respondent and one Monaghan, and the income to be distributable one-half to each. (R. 21.) Checks representing one-half of the partnership profits were drawn payable to respondent and by him deposited in a joint bank account on which both taxpayer and his wife could draw unrestrictedly. (R. 20.) Respondent's wife took no part in the management of the business of the Eagle Laundry

Company and made no contribution to its capital. (R. 20.) There was never any formal accounting between respondent and his wife. (R. 20.)

The Board of Tax Appeals held in effect that the respondent's wife was not, by virtue of the agreement mentioned above, a partner in the Eagle Laundry Company; and that even if she were considered a subpartner or in partnership solely with respondent, the income earned on the one-half interest standing in the name of her husband would first be income distributable to him, taxable as such, before its division with her. (R. 21.)

The Circuit Court of Appeals held that under Section 218 (a) of the Revenue Act of 1918 it was unnecessary to determine whether respondent's wife became a partner since, in any event, she owned half of the profits received by her husband, so that he was only taxable on the half he was entitled to retain.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding, in effect, that it was not the purpose of Section 218 (a) of the Revenue Act of 1918 to require each individual partner to return for income-tax purposes all of his distributive share of the partnership income.

2. In holding that the agreement between respondent and his wife entitled him to deduct from his taxable income received from the partnership all payments to her under their agreement.

3. In holding that a partner may transfer his distributive share in partnership profits to one not a partner, and so escape taxation upon the partnership income received by him and paid to such transferee.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is directly in conflict with the decisions of the Circuit Court of Appeals for the Second Circuit in *Mitchel* v. *Bowers*, 15 F. (2d) 287, certiorari denied, 273 U. S. 759, and in *Harris* v. *Commissioner*, 39 F. (2d) 546, in which it was held to be the purpose of Section 218 (a) of the Revenue Act of 1918 to tax partnership income by taxing the distributive share of each partner and that a partner could not by agreement with one not a member of the partnership obtain the right to deduct from taxable income payments made or to be made to such person. See also *Hill* v. *Commissioner*, 33 F. (2d) 165 (C. C. A. 1st), certiorari denied, 281 U. S. 761.

2. The decision of the Circuit Court of Appeals is also in conflict with the principles laid down in *Bing* v. *Bowers*, 26 F. (2d) 1017 (C. C. A. 2d), affirming 22 F. (2d) 450; *Leydig* v. *Commissioner* 43 F. (2d) 494 (C. C. A. 10th); and *Rosenwald* v. *Commissioner*, 33 F. (2d) 423 (C. C. A. 7th), certiorari denied, 280 U. S. 599. In these cases it was established that so long as a taxpayer remains the owner of income-producing property, the income therefrom is taxable to him, even though

he assigns or makes a gift of such income in advance of or after receipt.

3. The decision of the court below is also in conflict with the principle laid down by this Court in *Lucas* v. *Earl*, 281 U. S. 111, where it was held (p. 115) that the tax on compensation for personal service "could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it." The case was grounded upon the intent of Congress to measure the tax by compensation for personal service and is especially apposite here because the pertinent statute provides that in computing the net income of each partner his distributive share of the net income for the taxable year shall be included whether distributed or not. The statute plainly announces the intent of Congress to hold partners accountable for all partnership income and the decision of the court below in permitting the taxpayer to divide partnership income with one who is not a partner before the tax attaches, and so to escape a portion of the tax, is clearly contrary to the express direction of the statute and in conflict with the principle announced in *Lucas* v. *Earl*, *supra*.

4. The question is of considerable importance in administering the Federal income tax laws since it is one of frequent recurrence and is involved in cases now pending in the courts, the Board of Tax Appeals, and the Bureau of Internal Revenue.

Without a decision of this Court the Commissioner of Internal Revenue is unable to determine the proper principle to be applied in such cases, and acceptance of the decision in the present case would leave the matter in confusion because of the conflict between the decisions of different Circuit Courts of Appeals. Although the petitioner believes that in *Lucas* v. *Earl, supra,* this Court has announced the proper principle to be applied in such cases, confusion results from the fact that the Circuit Court of Appeals apparently holds that *Poe* v. *Seaborn,* 282 U. S. 101, qualifies the principle relied on in the *Earl* case. It is important in the administration of the revenue laws that all doubts with respect to the scope of the decision in the *Earl case* should be set at rest.

Furthermore, the decision of the court below would permit taxpayers who are partners to escape taxation on a part of partnership income by making similar agreements with members of their families or others not members of the partnership, and this presents a question of the gravest importance in protecting the Federal revenue against tax evasion.

Wherefore it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

SEPTEMBER, 1931.

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